

Why china seek  
regional free trade  
agreements  
economics essay



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As the world is getting ' flatter', the business environment crosses the national boundaries and is on the competitive edge. Businesses are subjected to the strong market forces and international trade. Most businesses, especially the multinational enterprises (MNEs), have their major sales within their home ' triad' (Rugman and Verbeke, 2004). The reason is that the countries within certain region ally to form trade blocs and eliminate trade barriers. For example, the European countries have integrated to the European Union single economy in order to compete with the American economy. By having free trade agreements, countries can trade and benefit from the reduction in import controls and lower taxation within the same region. This is more prevalent in current business environment as countries can gain more comparative advantages from free trade and reduce political conflicts. But there are some costs to these economic integrations.

Since the opening up of the economy in 1978, China has become one of the largest economies in the world. Amongst the emerging countries of the world, China is the fastest growing economy. Since 1982, it has enjoyed a

steady growth rate maintaining at around 10%[1]. China has put a lot of effort to expand its economy globally, and in 2001, it celebrated its accession into the WTO after 15 years of negotiations of the terms of entry.

### **China's situation for regional free trade agreements**

China has some great advantages or competitive advantages in trading. First of all, it has a much faster growth rate than the other developing countries which gives China a more developed and well balanced industry. Secondly, the Chinese government are willing to and have enough resources to develop exports, new industries and new export processing zones (EPZs). Thirdly, China has different zones for different manufacturing purposes: the Pearl River Delta is packed with labour intensive factories, producing small spare parts and assembling different parts; Yangtze River Delta is a special region for industries that needs a lot of capitals, for example, mobile phones, notebooks and computers, as well as cars, etc. Last but not least, China is a huge country with a population of 1.3 billion which means that it has a massive labour force which accommodate almost two-thirds of the world's EPZs workers. The labour in China is very cheap and so products from China are relatively cheap.

These advantages show that China has a very successful manufacturing industry, however, in order to support the GDP growth, China had to promote its exports. It is done by trade liberalization. China started to establish a market-oriented economy in 1980s. Trading was no longer planned and a lot of foreign trading companies were set up since then.

While promoting exports, China introduced strong import protection measures which has hindered exports by increasing cost of capital goods (Madhav, 2004). Tariffs were increased and non-tariff barriers were introduced in order to protect the domestic market. These were improved during the course of the WTO accession negotiation as China had to show its commitments to open trades. In order to join the WTO, China agreed to reduce its tariffs on different produces and remove all the quotas, licenses and other non-tariff barriers for manufactured goods by 2008. However, the accession of WTO has been very long and painful; therefore in order to reduce the problem, China has engaged in free trade agreements.

## **China's Free Trade Agreements**

The definition of Free Trade Agreement, as defined in the Business Dictionary, is:

“ Treaty (such as FTAA or NAFTA) between two or more countries to establish a free trade area where commerce in goods and services can be conducted across their common borders, without tariffs or hindrances but (in contrast to a common market) capital or labour may not move freely.”[2]

China has some unusual developments in its relationship with other countries; it is that as a developing country, China has been very active towards implementing free trade agreements (FTAs) since its first proposal of FTA to Association of Southeast Asian (ASEAN) in 2000. Until now, China has already established 12 free trade areas with 29 countries across the world[3]. These include the China-ASEAN FTA signed in November 2002 and the China-Hong Kong/Macau Closer Economics and Partnership

Arrangements signed in 2003. In the Northeast Asia, China has proposed a FTA with Japan and the Republic of Korea (ROK). In South America, China has established FTAs with Chile and Peru. The FTAs in Europe are under negotiations with Iceland and Norway. China even have FTA negotiations undergoing in Africa. Appendix 2 is a full list of China's FTAs.

Unlike the United States, as a developing country China does not have a frame or template to the FTAs. Each of the China's FTAs has different tariff levels, cut down of nontariff barriers and Rules of Origin, and the new FTA do not have to model the previous ones. But China tends to have a preferred order in the negotiation of FTAs: trade in goods first, followed by trade in services and then investments. Each stage of the FTAs is implemented gradually in a long period of time, for example, the tariffs on goods can be reduced in stages to zero, in a few years of time. As there is not a frame, China can set up its own rules; for example in the China-ASEAN FTA, China has excluded many sensitive products in the trade in goods agreements.

## **Motivations**

An FTA aims to integrate two countries or regions economics by removing most or all of the tariffs on goods and should bring economic benefits to both sides of the FTA, by definition. However, looking at the FTAs that China has launched so far, it is not difficult to see that China's decisions on FTA partners are not totally based on economic reasons. In the following section I am going to talk about both the economic and political drives of China's move into FTAs.

### **Economic Motivations**

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As mentioned before, China is one of the world's largest economies and has an average GDP growth of around 10% in the past years. Exports have been the major source of GDP growth and China has expected exports to grow after the accession into WTO. However, the growth rate has been below the expectation, therefore China needs some other short term strategies to increase exports, and one of them is establishing FTAs with other countries.

FTAs help China to gain access to multiple export markets. China mainly exports to markets like Europe, the US and Japan before any of the FTAs were signed. Its over dependent on these markets have forced China to use FTAs as its trade security because many of the countries launch discriminatory anti-dumping measures against China. As most of FTAs have been proposed by other countries, it is less likely that the FTA partners will use anti-dumping and other restrictive measures against China.

One example was the China-ASEAN FTAs. It was proposed by China in 2002, and the Framework Agreement was signed in November 2002. The Agreement on Trade in Goods, the Agreement on Trade in Services and the Agreement on Investments were signed in November 2004, January 2007 and August 2009 respectively. China gained access to these 10 countries (6 old and 4 new) by offering to remove most tariff and all non-tariff barriers, as well as introducing the Early Harvest program which is a unilateral concession on imports of agriculture. The growth rate of China's trade with ASEAN is an average of 22% per year[4] since the establishment of the FTA and has jumped to US\$193billion in 2009, exceeding that of the US. It has made the two sides one of the biggest trading partner of each other and it has reduced China's trading dependent on the US.

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Furthermore, China pressured that the WTO membership would help the opening up of trade and economy between China and the WTO members, but the anti-dumping measures and other restrictions have made it very unfair to China. Therefore China goes into FTAs as it is easier to negotiate with a smaller group of countries. It is also believed that the regional trade blocs may later connect with one another and this is hopefully leading to free trade in the world.

China believes that the costs for Chinese customers are reduced by the FTAs, for examples, the tropical fruits from ASEANS countries and the wine and dairy products from Australia. It also reduces the price for Chinese producers; it is because the manufacturer can import cheaper parts from ASEAN countries other than from Japan or the US.

Quality of the goods is also improved for Chinese consumers due to the FTAs as they have enhanced the competition in the domestic economy. It is because better quality goods can be imported to China, the local enterprises have to improve their goods and reduces their prices to compete with the goods from abroad. It helps the ongoing of reform of SOEs which is a very good preparation for globalisation. FTAs also attract foreign investments into China which helps to improve and develop the Chinese industries and generates more jobs opportunities.

China is growing very fast and in order to support the sustainable growth, it has to ensure it has enough resources. China is now the second largest importer of crude oil and its demand is going to grow constantly with the growth of its industry. In order to ensure its supply of raw materials and

energy, China has to go for the FTAs with Australia, the Gulf Cooperation Council and the SACU who are rich in energy and raw materials.

China has a very important aim for its economy; to be recognised as a market economy. China is not recognised as a market economy by quite a few countries which cause restriction measures like anti-dumping to be launched against it. Therefore China is determined to gain this status from other countries, and has already obtained it from 77 countries. The recognition of China as a market economy is kind of like a precondition to start any FTA negotiation, and this is the reason why the China-Indian FTA negotiation is taking so long as India would not recognise China as a market economy. While being recognised as a market economy by some developed countries, China is hoping it will force other major WTO members to do the same.

An example to demonstrate this purpose is the FTA between China and New Zealand. China happily signed the FTA in April 2008. It is a very important FTA for China because of four “firsts”; it was the first bilateral negotiation that China has completed, for the entry into the WTO; New Zealand was the first country to acknowledge China’s market economy status; New Zealand was also the first country to negotiate a free trade zone with China; and it was the first FTA that china has completed with a developed country.

#### Political Motivations

The reasons for China’s enthusiastic attitude towards FTAs are not just because of the economic considerations. There is something that China



cares more about: the political relations that will be brought about by the economic relations (Hufbauer and Wong, 2005).

In terms of foreign relations, it would be more important for China to establish good relationships with its neighbouring Asian countries and China is trying to achieve this by “ taking less, giving more” in FTAs. For example, in the China-ASEAN FTA, China introduced the Early Harvest program (EHP), which reduced the tariff to zero on eight categories of agricultural products. One special point about the EHP is that China has give unilateral concessions to the ASEAN members, which makes it more attractive to the ASEAN countries, as Japan and South Korea are not willing to do the same.

The “ taking less, giving more” policy, in China-ASEAN FTA as well as some other China’s FTAs, has strengthened the political relationships between China and its FTA partners. It is believed that through FTAs, China can get together its partner to sit at a better position to compete with the stronger countries like Japan and the US. It is also believed that by setting up the rules in its bilateral and regional relations, China is gradually gaining power in the global grounds.

The other purpose of the China-ASEAN FTA is to relieve the worries about the “ China Threat” among the other Asian countries. In recent decades, especially the accession into WTO, China has emerged as an economic power and the dominant economic force in the East Asia. This fact puts a lot of pressure onto China’s economically-weaker neighbours. Therefore through the China-ASEAN FTA, especially with the EHP, China shows the others that it

is not a threat but an opportunity to them. It has hopefully created a peaceful and friendly environment for the ASEAN members.

Another political motivation for China's FTAs is to promote its "One China" policy. It is quite obvious that the China-Hong Kong CEPA does not grant China economic benefits. However, it has a very important political role; to show Taiwan how well the 'One Country, Two Systems' works in Hong Kong. China's long term goal is to unify China, Hong Kong, Macau and Taiwan, and establish of the "Great China Economy Circle" by integrating the economies.

This was demonstrated by the China-Hong Kong/Macau Closer Economic and Partnership Arrangement (CEPA) and the supplements. The CEPA was signed in 2003, in order to enhance the economic and trade growth in Hong Kong and Macau. The agreements implement zero tariffs on Hong Kong/Macau originated goods, remove any nontariff barriers on goods, liberalize services and promote investment. It provides unique opportunities to Hong Kong/Macau, compared to the other FTAs, as the service providers can gain access to China's market by January 2004 other than December 2007 which was stated in the WTO accession agreement.

## **Outcomes**

China is now the largest exporter and second largest importer. The exports have increased from 183712 million US dollars in 1998 to 1428332 million US dollars in 2008[5]and have exceeded Germany in 2009. It is proved that China's motivations of going into FTAs have indeed become the benefits and outcomes of FTAs.

Although FTAs have a lot of benefits, there are still some costs or disadvantages. FTAs might be a win-win policy but only limit to the economies within the same region. Also, economically weaker countries have less bargaining power to negotiate the agreements and the negotiations are often very resource intensive. The domestic economy might become instable as the market might become dependent on global market, or the domestic industries might not be able to withstand the completion from global markets.

China understands the risks it is taking but is confident about minimising the loss from the FTAs. It is because China is confident with its foreign trade by looking at the rapid economic growth in the past two decades. China also has confidence in doing well in a free trade environment as it is the world's largest exporter and second largest importer. China understands its own competitive advantages mentioned before, and is confident that it would benefit more than other countries as it can manufacture products in a lower price.

## **Conclusion**

As mentioned before, China is very active towards FTA. Its incentives for the establishment FTAs are both economical and political. One of the main reasons is to relieve other countries' fear on the "China economic threat" after joining the WTO, and to show them that China's rising in economy is an opportunity for them. By doing this China has built up good relationships with other countries. China uses the FTAs to bind its partners together, to hopefully gain a better position to compete with the stronger countries.

China also uses the China-Hong Kong CEPA to promote its "One China"  
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policy and to show Taiwan one of the economical advantages to unify with China.

In terms of the economic side, China realises the advantages of FTAs of bringing substantial economic benefits. These includes: increasing exports and expending it to other markets, reducing costs for Chinese consumers and manufacturers. FTAs also improve quality of goods in China by introducing domestic competition, which also helps in the reform of industry. China also uses FTAs to ensure its stable supply of energy and resources for a sustainable growth in the future. The last, but very important motivation is that China needs to gain market economy status from other countries in order to avoid the very discriminating anti-dumping measures from others WTO members.

FTAs satisfy China's pragmatic, strategic and flexible wish in trade and economic negotiations with the other countries, and has helped China in gaining market access, as well as politic relationships. Although there are risks and cost of FTAs, China have confidence to overcome them and therefore it is very likely that China will continue its enthusiasm in FTAs and reduces its overdependence on the West.